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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

December 9, 1992

Ex Parte

Ms. Donna R. Searcy  
Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

Re: **CC Docket No. 92-101**

Dear Ms. Searcy,

The attached information concerning the Statement of Financial Accounting Standards No. 106 is provided in response to a question raised by Kathleen Abernathy, Legal Advisor to Commissioner Sherry P. Marshall. Please include this material as part of the record of the above-captioned proceeding.

If you have questions, I can be reached at 202-392-6980.

Sincerely,



cc: Kathleen Abernathy  
Lauren Belvin  
Madelon Kuchera  
Linda Oliver  
Charla Rath

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## BELL ATLANTIC

## EXOGENOUS COST CHANGES

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12/07/92

Effective Date	Description	Common Line	Switched Access	Special Access	Inter - exchange	TOTAL
01/01/91	BA Transmittal # 394 - November 15, 1990 EXG-1					
	12% ROR TO 11.25%	(20,475)	(18,668)	(8,161)	0	(47,304)
	Disallowance Adjustment	2,673	1,732	856	0	5,261
	LTS/TRS	(1,853)	0	0	0	(1,853)
	Total	(19,655)	(16,936)	(7,305)	0	(43,896)
07/01/91	BA Transmittal # 445 - June 27, 1991 EXG-1					
	SPF Transition	(5,308)	0	0	0	(5,308)
	DEM Transition	0	(14,686)	0	0	(14,686)
	LTS/TRS	(33,102)	0	0	0	(33,102)
	Inside Wire (ISW)	0	0	0	0	0
	Reserve Deficiency Amortizations (RDA)	(12,486)	(9,867)	(4,588)	(67)	(27,008)
	Excess Deferred Taxes/ITC	525	785	313	13	1,636
	Total	(50,371)	(23,768)	(4,275)	(54)	(78,468)
03/19/92	BA Transmittal # 492 - February 18, 1992 Figure 5-1					
	PURTA	999	651	359	19	2,028
07/01/92	BA Transmittal # 513 - June 29, 1992 EXG-1					
	SPF Transition	(4,415)	0	0	0	(4,415)
	DEM Transition	0	(10,607)	0	0	(10,607)
	LTS/TRS	(28,821)	0	0	0	(28,821)
	Inside Wire (ISW)	(770)	(686)	(286)	(4)	(1,746)
	Reserve Deficiency Amortizations (RDA)	(12,712)	(11,642)	(4,796)	(46)	(29,196)
	Excess Deferred Taxes	1,600	1,476	618	5	3,699
	ITC	716	712	250	3	1,681
	Sharing	(9,880)	(8,036)	(3,139)	(1,126)	(22,181)
	Non-Regulated	(2,840)	(1,853)	(1,019)	(13)	(5,725)
	Total	(57,122)	(30,636)	(8,372)	(1,181)	(97,311)

423. In addition to the exogenous costs named by the Commenters, we propose to flow through to price caps cost changes occasioned by changes to our Part 32 rules. These rules specify carrier accounting practices for expenses, investment, and revenues. A change in accounting treatment may produce substantial changes in carrier costs and, like jurisdictional separations, is imposed by this Commission. We tentatively find, therefore, that changes to our Part 32 rules should be considered an exogenous change in carrier costs.

- *FNPRM, CC Docket 87-313, May 23, 1988.*

294. In the Further Notice we proposed to treat as exogenous cost factors any changes in carrier costs which are caused by changes in Part 32 of our Rules, the Uniform System of Accounts. All parties commenting on this proposal support it. Several LECs propose that we also include cost changes brought about by changes in generally accepted accounting principles (GAAP). They argue that, although GAAP changes do not always require changes in the USOA, they have the same effect as USOA changed and are equally outside the carrier's control.

295. We confirm our tentative conclusion that cost changes due to changes in the Uniform System of Accounts should be treated as exogenous cost factors. We also agree that there is no difference in principle between a cost change caused by a USOA change and a cost change caused by a GAAP change.<sup>805</sup> We do not, however, authorize carriers automatically to adjust price caps to reflect changes in GAAP. Our current procedures for implementing GAAP in the context of the USOA require carriers to notify us of their intention to apply a change in GAAP. They may make the change only if we find it to be compatible with regulatory accounting needs. Some changes in GAAP which are compatible with regulatory needs can be carried out within our existing rules, while others may require amendment of the USOA. A carrier may not adjust its price caps to reflect a change in GAAP until we have approved that change.

<sup>805</sup>. Changes in generally accepted accounting principles are adopted by the Financial Accounting Standards Board (FASB). One could say that GAAP changes affect all entities in the economy and thus are already reflected in the GNP-PI. However, following this line of reasoning would require us by the same logic to prohibit exogenous cost changes for USOA changes that implement GAAP. Furthermore, it is not always clear that GAAP changes, implemented within a regulated system of accounts, have the same impact on carriers as the same changes implemented by industries which do not follow regulated accounting practices. Therefore we conclude that all accounting changes imposed by outside regulatory authority can give rise to exogenous cost adjustments.

654. USOA Changes. All those commenting on the treatment of costs attributable to changes in our Uniform System of Accounts agree that these costs should be considered exogenous. We have adopted this proposal for AT&T and we again tentatively adopt it for the LECs. In their pleadings, several LECs argue that costs arising from changes in generally accepted accounting principles, or GAAP, should also be considered exogenous. In Section III we agree with their conclusion that it is difficult to distinguish changes triggered by an amendment to our USOA from those triggered by a change in GAAP. Nonetheless, because changes in GAAP cause changes in the regulatory accounting procedures of carriers under our jurisdiction only after we find such changes compatible with regulatory accounting needs, we conclude in Section III that AT&T should adjust its price cap to reflect changes in GAAP only after we have approved such a change. We now propose the same treatment of GAAP changes for the LECs.

- *R&O and Second Further Notice, CC Docket 87-313, April 17, 1989.*

4. Although the accounting change AT&T seeks to claim as exogenous will probably be mandated by FASB in 1992, and at that time qualify for exogenous treatment, AT&T's decision to implement this change before any change is mandated by FASB or this Commission's accounting rules does not result in a cost change that can be treated as exogenous under the Commission's rules. Section 61.44(c)(2) of the Commission's Rules specifically provides for a mechanism to reflect Commission-mandated changes in the USOA. In the Price Cap Order, the Commission stated that Section 61.44(c)(2) exogenous costs can be either cost changes resulting from a change in its accounting rules or in any Commission-approved change in GAAP. Neither the language of the rule, or the language of the Price Cap Order, enable AT&T to claim as exogenous a proposed change in GAAP or USOA.

5. AT&T apparently contends that this cost change is an "extraordinary exogenous cost change" for the purposes of Section 61.44(c)(5). That interpretation is incorrect. Cost changes must be both extraordinary and exogenous to qualify as extraordinary exogenous cost changes. The term "exogenous" is consistently used throughout the Price Cap Order and the Further Notice to describe costs that are not within the carrier's control. Although the cost changes that result from implementation of this accounting change at this time might be viewed as extraordinary for some purposes, the changes were clearly within AT&T's control and accordingly cannot be classified as exogenous for purposes of the Commission's Rules.

- *MO&O, Transmittal No. 2304, June 27, 1990.*

## B. USOA Amendments; GAAP Changes

168. Changes in LEC costs that are caused by changes in Part 32 of our Rules, the Uniform System of Accounts (USOA), will be considered exogenous. We make this classification on the basis that such changes are imposed by this Commission and are outside the control of carriers. However, carriers are not authorized to adjust their price caps automatically to reflect changes in generally accepted accounting principles (GAAP). As explained in the Second Further Notice, certain GAAP changes may require amendment to the USOA while others may not. Carriers must notify us of their intention to apply a change in GAAP and we will allow such change if we find it to be compatible with our regulatory accounting needs. No carrier may adjust its price caps to reflect a change in GAAP until we have approved the carrier's proposed change. Furthermore, we wish to clarify that no GAAP change can be given exogenous treatment until the Financial Accounting Standards Board has actually approved the change and it has become effective. The cap mechanism is intended to reflect changes in costs that have occurred, not anticipated cost changes.

- *Second R&O CC Docket 87-313, October 4, 1990.*

## 2. USOA/GAAP Changes

74. The AT&T Price Cap Order made changes in Generally Accepted Accounting Principles (GAAP), brought about by action of the Financial Accounting Standards Board, exogenous if the Commission approves the change as compatible with its regulatory accounting needs. One party disputes this treatment, arguing that it will result in double-counting of costs changes already reflected in the Gross National Product Price Index (GNPI-PI). It argues that GAAP changes should be considered exogenous only on a case-by-case basis where the effect of a GAAP change is unique or disproportionate to the carrier.

75. We agree with the DC PSC. As we have recognized in the case of tax law changes, GAAP changes should be eligible for exogenous treatment after a case-by-case review indicates that the change will not be adequately reflected in the GNP-PI. Thus, AT&T must demonstrate that a GAAP change it seeks to treat as exogenous will not be double counted in the Price Cap Index, once in the GNP-PI and once as an exogenous cost. In deciding to treat GAAP changes as exogenous on a case-by-case basis instead of automatically treating them as exogenous, we must also revisit the rationale found in the AT&T Price Cap Order supporting the original decision. That

Order stated that it is "not always clear" that GAAP changes have the same effect on carriers as on industry generally. Upon reconsideration, we decide that we should take more seriously the absence of clarity on the question of possible double-counting and evaluate GAAP changes on a case-by-case basis.

- *MO&O on Reconsideration, Docket 87-313, February 8, 1991.*

### C. Exogenous Costs

58. In the LEC Price Cap Order, we recognized that some cost changes triggered by administrative, legislative, or judicial action beyond the control of the carriers would not be reflected in the other components of the Price Cap Index. We called these cost "exogenous," and found that these costs should result in an adjustment to the Price Cap Index. We found that exogenous costs include separations changes, amendments to the Uniform System of Accounts (USOA), changes in long term support and transitional support payments, the expiration of amortizations, and the reallocation of regulated and nonregulated costs. We decided that other costs should be classified as endogenous, *i.e.*, such cost changes do not affect price cap index levels. LEC Price Cap Order, 5 FCC Rcd at 6807, para. 166.

#### 1. Other Post-Employment Benefit Costs

59. Other Post-Employment Benefits (OPEB) is the accounting term used to describe health and other benefits corporations provide to their retirees. The Financial Accounting Standards Board (FASB), the body responsible for establishing Generally Accepted Accounting Principles (GAAP), has amended GAAP to require accounting treatment of OPEB costs on an accrual basis starting in 1992. In the LEC Price Cap Order, we stated that price cap regulation does not affect our prior practice of requiring carriers to notify us of their intention to implement a change in GAAP. LEC Price Cap Order, 5 FCC Rcd at 6807, para. 168. We stated that where we find a GAAP change to be compatible with our regulatory accounting needs, we will consider whether amendment of our Uniform System of Accounts is necessary or desirable. We stated that no carrier could treat GAAP changes as exogenous until we approved the change, and that exogenous treatment would not be granted until FASB had actually approved a change in GAAP, and the change became effective.

60. AT&T says that some LECs have begun accounting for OPEB costs on an accrual basis, and therefore OPEB costs are embedded in the price indices for these LECs. AT&T notes that when it attempted to include OPEB costs as exogenous, the Common Carrier Bureau denied exogenous treatment, finding that the FASB change had not yet become effective. AT&T argues that there is no reason to treat LEC OPEB costs differently than AT&T OPEB costs. AT&T advocates reducing the PCIs of LECs who included OPEB costs in their rates prior to the effective date of price cap tariffs. MCI argues that, since FASB does not require accrual treatment of these costs until 1992, this change is voluntary and therefore does not deserve exogenous treatment as a change in GAAP standards. ICA states that OPEB accounting standards may be revised before 1992, and therefore supports endogenous treatment of these costs.

61. The OPEB expenses some LECs have embedded in their July 1990 rates were introduced pursuant to existing accounting rules that permitted LECs, at their option, to change their accounting treatment of OPEB expenses. No change in GAAP was necessary, no change in our USOA was necessary, and therefore no Commission notification was required for these LECs to implement a different way of accounting for OPEB expenses. Carriers that chose to accrue OPEB expenses were not more "right" or "wrong" than carriers that chose to await the GAAP change. Under the rate of return regulatory structure, as long as the carrier's costs are reasonable and prudent, those costs can be used in the ratemaking process to justify rates.

62. Our change in regulation, from rate of return to price caps, should not result in our changing the treatment of such costs. While a regulatory change may affect prospective treatment of these expenses, costs and rates that have been accepted as reasonable and prudent under prior standards should not be treated as unreasonable or imprudent merely because our regulations have changed. Indeed, those seeking to exclude OPEB expenses from price indices do not make such a claim. They focus instead on the "fairness" issues raised by our price cap decision to consider exogenous costs treatment of GAAP changes at the time the GAAP change is implemented, in this case 1992. Our decision not to consider exogenous treatment of GAAP changes, including OPEB expenses, until the GAAP change become effective is one grounded in the orderly administration of our price cap system. The requirement ensures that we will not be called upon to render decisions prior to the time FASB has made a final ruling. We believe such a requirement will be helpful to our administration of price cap regulation. We believe declining to decide this OPEB issue until it becomes ripe will result in fairer treatment of the LECs. Under this decision, carriers that elected to wait until the GAAP change becomes effective before expending funds for OPEB are not necessarily foreclosed from recovering these costs. Instead, we will consider requests for exogenous treatment at that time. On the other hand, removal now of already-accrued OPEB expenses from initial price cap rates would not only redefine "reasonable" after the fact, but it would also foreclose carriers from any recovery of expenditures already made.

63. Carriers may always attempt a showing demonstrating why they should not be held to the general requirement, supported by reasoned analysis giving good cause for the requirement to be waived. However, the carriers objecting here merely allege that our decision to address OPEB issues in 1992 is unfair to companies that had not switched to accrual accounting while they were under rate of return regulation. This is not a sufficient basis to advance consideration of exogenous treatment of a FASB-approved GAAP change. As stated here and previously, we will consider such applications for exogenous treatment only at the time the change becomes effective. Further, the test of whether to grant exogenous treatment of GAAP changes is not restricted to whether the change is outside the control of the carrier, as GTOC suggests. As we discussed in the AT&T Price Cap Reconsideration Order, the determination of whether a particular GAAP change is exogenous includes an analysis of whether the cost change will be reflected in the inflation variable of the PCI. If a GAAP change is universal enough to be reflected in the inflation measure, exogenous cost treatment would result in double counting within the context of the PCI.

- *Order on Reconsideration, CC Docket 87-313, April 17, 1991.*

3. The Commission had decided that it would incorporate changes in generally accepted accounting principles provided that such changes do not conflict with its regulatory objectives. After reviewing SFAS-106, we have concluded that its adoption for accounting purpose will not conflict with the Commission's regulatory objectives. Accordingly, we are authorizing carriers to implement SFAS-106 on or before January 1, 1993.

- *Order, AAD 91-80, December 26, 1991.*

The purpose of this letter is to provide the requested guidance with respect to accounting for postretirement benefits under SFAS-106 in Part 32 and to address other implementation issues which we believe will surface as more carriers begin adopting this methodology.

The following Part 32 accounts shall be used to record the effects of SFAS-106 on carrier regulatory books of account.



**Account 4310, Other Long Term Liabilities.** This Account shall be used to record the amounts accrued for postretirement benefits. Companies shall credit this account for the net periodic cost of postretirement benefits recorded in the expense account matrix for the current year and shall debit this account for any fund payments made during the current year... If fund payments would cause the postretirement benefits portion of Account 4310 to have a debit balance, then the debit balance applicable to postretirement benefits shall be reported in Account 1410, Other Noncurrent Assets.

**Account 5999(f), Expense matrix.** The benefits portion of the expense matrix shall be used to record the current year's net periodic cost of postretirement benefits in the Part 32 expense accounts. Prior to adopting SFAS-106, carriers shall continue to use Account 6728, Other General and Administrative, for recording direct payments made to or on behalf of retire employees.

**Account 1410, Other Noncurrent Assets.** This account shall be used to record the amount of any prepaid postretirement benefit cost.

Amortization period for transition obligation. One of the implementation issues raised by the December 26 Order concerns the amortization period for the transition obligation. That order could be interpreted to require carriers to amortize the transition obligation over a period of twenty years. This was not the Bureau's intent in authorizing carriers to adopt SFAS-106. Carriers should use the period(s) set forth in paragraphs 112 and 113 of SFAS-106 for amortizing the transition obligation for regulatory accounting purposes.

Notification. The Bureau's Order did not state when carriers should notify the Commission in the event they implement SFAS-106 or specify the contents of the notification. We are requiring that written notice should be provided within thirty days of when a carrier adopts SFAS-106 for regulatory accounting purposes...

Rate base treatment. Several carriers have raised the issue of whether the postretirement amounts recorded in Account 4310 and 1410 should be reflected in the interstate rate base. It is our opinion that postretirement benefits are similar to pension expenses recorded in Accounts 4310 and 1410 and as such should be given the same rate base treatment. Therefore, the interstate portion of unfunded accrued postretirement benefits recorded in Account 4310 should be deducted from the rate base and the interstate portion of any prepaid postretirement benefits recorded in Account 1410 should be added to the rate base.

The FCC's Common Carrier Bureau allows exogenous treatment for an ice storm.

*DA 92-80, Transmittal Nos. 162 and 164,  
January 22, 1992*

### III. Discussion

8. A fundamental tenet of price cap regulation is that the increased earnings possible under incentive-based regulation yield reasonable rates only to the extent the carrier experiences increased risk. Although the basic price cap formula is intended to reflect, on an averaged basis, cost changes carriers are likely to expect, carriers are no longer insulated from every cost change they experience, as they generally were under rate of return regulation. Stated differently, the price cap index is intended to create a "benchmark" measure of cost changes. The added risk flows from the LEC's efforts to beat the benchmark -- i.e., produce cost changes that are lower or less than the benchmark.

9. The basic component of the price cap formula, GNP-PI minus productivity, constitutes the benchmark cost changes that price cap carriers are challenged to meet. In fairness to both carriers and ratepayers, however, the basic measure of cost change can be further adjusted upward or downward to account for certain specified cost changes unique to the carrier. These are exogenous costs. The limited list of exogenous cost changes codified in the Commission's Rules at Section 61.45(d) allow the price cap to fluctuate in response to certain specific cost changes that are (1) imposed by government action; and (2) which are unique to or disproportionately affect common carriers. The Commission determined that these cost changes are not likely to be reflected in the inflation measure.

10. Tax law changes are presumptively endogenous, i.e., already taken into account in the GNP-PI and therefore in the price cap formula. Tax law changes imposed by any level of government that uniquely or disproportionately affect LECs individually or as a class may, however, qualify for exogenous cost treatment. If a tax can be shown to have unique or disproportionate effect on common carriers, then the amount of the exogenous adjustment must be examined carefully to determine if the cost changes at issue are already reflected in the GNP-PI inflation measure. Exogenous treatment of tax changes that are already accounted for in the GNP-PI would "double-count" their effect (once as an exogenous cost change and once in the GNP-PI), a result that is inconsistent with the goal of price cap regulation to encourage cost based rates. The burden is on the LEC to show the absence of double counting.

*DA 92-175, Transmittal No. 473, February  
10, 1992.*

**§ 61.45 Adjustments to the PCI for Local Exchange Carriers**

(R-6) (d) The exogenous cost changes represented by the term " $\Delta Z$ " in the formulas detailed in paragraphs (b) and (c), shall be limited to those cost changes that the Commission shall permit or require.

(R-9) (1) Subject to further order of the Commission those exogenous changes shall include cost changes caused by:

(i) the completion of the amortization of depreciation reserve deficiencies;

(ii) such changes in the Uniform System of Accounts as the Commission shall permit or require; and

(iii) changes in the Separations Manual;

(iv) changes to the level of obligation associated with the Long Term Support Fund and the Transitional Support Fund described in § 69.612 of this chapter;

(v) the reallocation of investment from regulated to nonregulated activities pursuant to § 64.901;

(vi) such tax law changes and other extraordinary exogenous cost changes as the Commission shall permit or require, and

(vii) retargeting the PCI to the level specified by the Commission for carriers whose base year earnings are below the level of the lower adjustment mark.

(viii) inside wire amortizations.